ISSUE DATE: August 28, 1997

DOCKET NO. G-012/M-96-1272

ORDER GRANTING RECONSIDERATION AND AFFIRMING JUNE 17, 1997 ORDER

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey	Chair
Joel Jacobs	Commissioner
Marshall Johnson	Commissioner
Don Storm	Commissioner

In the Matter of a Request by Western Gas Utilities, Inc. for Approval by the Minnesota Public Utilities Commission to Increase Its Demand Entitlements and for Approval of Purchased Gas Adjustment Recovery of the Increased Entitlements

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PROCEDURAL HISTORY

On October 24, 1996, Western Gas Utilities, Inc. (Western) requested permission to increase its demand entitlement (i.e. its entitlement to pipeline capacity) by 2,000 Mcf/day.

On December 24, 1996, the Minnesota Department of Public Service (the Department) submitted comments recommending Western be allowed to recover the cost of 1,092 Mcf/day of additional pipeline capacity entitlements. Western did not contest the Department's recommendation.

On June 17, 1997, the Commission issued its ORDER APPROVING INCREASE IN DEMAND ENTITLEMENTS, SYSTEM BALANCING AGREEMENTS AND PGA RECOVERY in this matter. In its Order, the Commission authorized Western to recover in rates through the PGA the cost of 878 Mcf per day of additional entitlement to firm pipeline capacity.

On July 7, 1997, Western submitted its petition for reconsideration.

On July 17, 1997, the Department submitted its answer supporting Western's request.

On August 14, 1997, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

A. Western's Petition for Reconsideration

Western requested that the Commission reconsider its decision authorizing Western to recover the cost of 878 Mcf per day of additional firm pipeline entitlement rather than the 1,092 Mcf per day of entitlement recommended by the Department. Western did not contest any other part of the Commission's Order.

As part of its request, Western disputed three of the Commission's findings:

1. that during the 1995-96 heating season, Western's 3.9% reserve margin was about average among the Minnesota local distribution companies (LDCs) (Order at page 2);

2. that the Department's proposal would nearly triple Western's reserve margin over the 1995-96 level (Order at pages 3-4); and

3. that the Company can use its status as a small LDC to take advantage of the 650 Mcf/day tolerance levels established for such small LDCs in FERC Order 636 (Order at page 4);

In addition, Western argued that the 214 Mcf/day difference between the authorized increase of 878 Mcf/day and the requested increase of 1,092 Mcf/day is significant. Western noted that 214 Mcf/day represents 3.3% of its total entitlement that has an annual cost of $13,616. Western stated that $13,616 is significant compared to the general increase in base rates of $122,728 authorized in Western's 1996 rate case, in Docket No G-012/GR-96-572.

In sum, Western requested the Commission to authorize an increase of 1,092 Mcf/day of pipeline capacity, as recommended by the Department. Western stated that the 214 Mcf/day of additional entitlement would provide it with an adequate reserve margin and allow Western to provide reliable service without incurring penalties.

B. The Department

The Department supported Western's petition. The Department argued that Western is different from other regulated gas utilities in Minnesota and this requires Western to have a higher reserve margin. The Department further noted that Western may incur pipeline penalties or that pipeline capacity will not be available if Western's peak-day demand (i.e., its peak-day load or send-out) exceeds the total Commission authorized amount of entitlement. Finally, the Department took issue with the Commission's finding that:

> ..... the Company can use its status as a small LDC to take advantage of the 650 Mcf/day tolerance levels established for such small LDCs in FERC Order 636.

In sum, the Department requested the Commission to grant the Company's petition for reconsideration and recommended approval of 1,092 Mcf/day rather than 878 Mcf/day of additional pipeline capacity.

C. Commission Analysis and Action

1. Reserve Margin for 1995-96

In its June 17, 1997 Order, the Commission had relied on the numbers and analysis contained in Table 12 of the Department's 1996 Review to conclude that the 878 Mcf/day increase would result in a reserve margin (approximately 6.5 percent) that was much more in line with the Company's previous (1995-96) reserve margin. Order at page 3. On review of the relevant record in this matter, the Commission agrees with the Company that its reserve margin in 1995-96 was lower than the numbers reported by the Department in the Department's
February 28, 1997, Review of the 1996 Annual Automatic Adjustment Reports,
(1996 Review), in Docket No, G, E-999/AA-96-940.

Although the Company's reserve margin in 1995-96 was lower than the 6.5 percent figure for 1996-97 established in the June 17, 1997 Order, this clarification is inadequate to persuade the Commission that an 878 Mcf reserve is inappropriate. As noted in the Order at page 3, the reserve margin resulting from the 878 Mcf/day additional capacity results in a reserve margin in line with industry averages and, for reasons addressed below, Western's size does not warrant a higher reserve margin.

2. Western's Previous Reserve Margins

Western argued that its request for a 10.1 percent reserve margin for 1996-97 was reasonable because it was in line with the 11.74 percent margin authorized by the Commission for
1991-92. The Commission notes that a more recent decision to authorize a reserve margin of approximately 9.2 percent for 1993-94 is somewhat more relevant. See In the Matter of a Request by Western Gas Utilities, Inc. for Approval to Increase and Change its Pipeline Demand Entitlements and to Recover the Associated Costs in its Monthly Purchased Gas Adjustment, Docket No. G-012/M-93-1251, ORDER APPROVING INCREASED ENTITLEMENTS, REQUIRING CLASSIFICATION OF CERTAIN FDD RATE ELEMENTS AS DEMAND COSTS, AND REQUIRING A REFUND (December 20, 1994).

On the whole, however, the Commission does not find arguments based on what the Commission decided for the Company in previous years to be as persuasive as the case-specific analysis of what reserve margin is actually needed. In this case, the Commission set forth in its June 17, 1997 Order the analysis that persuaded it that a 6.5 percent reserve margin was appropriate. Neither the Company nor the Department have shown where the Commission's analysis was faulty.

3. Small Utility Factor

Western and the Department have emphasized that Western is a small utility serving a high percentage of residential customers with limited supply options and that these characteristics warrant a higher than average reserve margin. However, although its reserve margin may not have tripled as indicated in the June 17, 1997 Order, an 878 Mcf per day increase resulting in a 6.5 percent reserve margin is a significant increase from the -341 Mcf/day (negative reserve margin/-5.9 percent) experienced in 1995-96. Moreover, as described in the Settlement documents submitted in the Company's 1996 rate case, recent construction projects have improved the reliability and operating flexibility of its distribution system by helping to equalize operating pressures and allowing Western to take gas off of the pipeline at several different receipt points to serve most (if not all) of its customers.

In these circumstances and based on the analysis of actual need set out in the June 17, 1997 Order, the Commission finds no basis for awarding the Company a special small utility reserve margin cushion.

4. Role of the 650 Mcf/day Tolerance Level

In Order 636, FERC has made provisions for small LDCs such as Western. In its tariffs, Northern Natural Gas Company (Northern) has responded by establishing a "tolerance level" for small customers such as Western, which allows the Company to take more or less gas than its scheduled daily volume (by at least 650 Mcf/day[1]) without incurring penalties, regardless of whether "critical day"operating conditions are in effect on the pipeline.

The Company and the Department emphasize that this amount (650 Mcf/day) is not the equivalent of additional capacity. However, the Commission did not mistake the nature of this amount in rendering its decision regarding the adequacy of a 6.5 percent reserve margin for 1996-97. While not the equivalent of firm capacity, the 650 Mcf/day extra tolerance does give Western more operating flexibility, approaching that possessed by larger LDCs due to their size. As acknowledged by the Department in previous comments, this extra tolerance allows Western to exceed its nominated amounts and provides an "insurance" buffer of sorts.

5. Risk of Penalties

The Company's assertion that a lower reserve margin increases the risk of Daily Delivery Variance Charges (DDVC) penalties is unquestionably true but the size of increase must be examined and placed in perspective. The risk of incurring punitive DDVC penalties is much greater for companies operating with lower and/or negative reserve margins and much less so for companies like Western that are currently operating with enough capacity to cover their design-day requirements. The Commission notes that according to Table 14 in the Departments 1996 Review, which is a comparison of the DDVC penalties paid by Minnesota LDCs during 1995-96, Western incurred a relatively small amount of penalties despite the severe weather and its -5.9% reserve margin.

Given the Commission's analysis 1) that the authorized amount of firm capacity

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[1] Northern's tariff establishes the tolerance level for small customers such as Western at the greater of 1) five percent of all scheduled volumes at the point or 2) 650 Mcf/day.

(6,304 Mcf/day) is adequate, 2) that the increased possibility of penalties alluded to by Western is minimal and adequately within the Company's control, the Commission concludes that capacity in excess of 6,304Mcf/day is unnecessary. In these circumstances, requiring the Company's ratepayers to pay for such additional capacity is simply unwarranted.

6. Significance of Amount Disallowed

Western argued that 214 Mcf/day represents 3.3% of its total entitlement. Western also argued that on an annualized basis, 214 Mcf/day of pipeline capacity would cost approximately $13,616. A $13,616 disallowance would consume a significant part of the rate increase authorized in its last rate case, which was $122,728.

The Commission does not believe the size of the disallowance, whether described in absolute or comparative terms, is particularly relevant. The size of a disallowance does not change the nature of the expenditure. Since the unrefuted analysis is that the expenditure for more than 6,304 Mcf/day entitlements was not reasonably necessary, the cost should not be recovered in rates.

7. A Question of Prudence

In its June 17, 1997 Order, the Commission stated the crux of the matter:

> The question is: what level of entitlements over and above average daily requirements is required to prudently provide for reliable service on the coldest days, i.e. what reserve margin it is prudent for Western to maintain. Setting the reserve margin too low would jeopardize continuous service on days of peak demand while setting the reserve margin too high would result in rates unnecessarily high, requiring ratepayers to pay for unnecessary reserve capacity. Order at page 2.

After a thorough review of the matter, the Commission reached the following conclusion:

> After considering Western's circumstances, the Commission finds that the Company should be able to operate reliably at a reserve margin higher than but still relatively consistent with the 1995-96 level,[2] thereby causing less upward pressure on the overall price of gas to its firm customers than would be experienced under either the Company's or the Department's proposals. The record shows that this can be done without jeopardizing adequate supply on days of peak demand. Accordingly, the Commission will approve an 878 Mcf/day increase in additional pipeline capacity entitlements and direct that this increase be prorated amongst Northern Natural's TF-5, TF-12B and TF-12 V services according to previously approved allocations. Order at page 3.

Having reviewed this matter further upon reconsideration, the Commission remains persuaded that its decision in the June 17, 1997 Order was correct. While retrospect is not the sole perspective to take on this question, it should be noted that Western was able to provide reliable service in 1995-96 despite a negative reserve margin and in 1996-97 with the
6.5 percent reserve margin approved in the June 17, 1997 Order. According to the Department's 1996 Review, Western's 1995-96 design-day requirement was 5,767 Mcf/day. This is a higher amount than Western's peak-day send-out of 5,659 Mcf/day during the severe Winter of 1995-96.

In addition, it should be noted that Western's peak-day (design-day) demand has never been exceeded in the last ten years despite the fact that several severe winters have been experienced during that time.

For 1996-97, Western's design-day requirement was 5,920 Mcf/day and the Commission has approved entitlements of 6,304 which is an amount sufficient to cover Western's design-day plus 100% back-up of its peak-shaving plant. No persuasive analysis has been presented to indicate that this amount is insufficient.

Finally, deciding how much reserve capacity it is prudent to allow Western to buy at its ratepayers expense is not the equivalent of deciding that a shortage will necessarily occur if demand exceeds the authorized entitlement. While the actual likelihood of exceeding the approved demand entitlement is essentially zero (as explained above), the Commission's decision in this matter does not put Western's ratepayers at risk of going without gas in the event that such entitlement is, in fact, exceeded. As the Commission noted in its June 17,1997 Order:

> Finally, it is important to clarify that what this Order authorizes is the level

[2] On further review, the Commission observes that its reference to "consistency" with the 1995-96 level is inaccurate. Western's reserve margin in the prior year (1995-96) was -5.9 percent, quite different from the 6.5 reserve margin approved for 1996-97. However, the cited consistency factor was not essential to the Commission's analysis and any absence of consistency in that area does not undermine the validity of its essential finding that the Company should be able to operate reliably with a 6.5 percent reserve margin. As noted elsewhere in this Order, the validity of reserve margins does not rely in any important way on the "precedent" of reserve margins previously approved for the Company.

of firm pipeline capacity that the Company will be authorized to charge to the ratepayers on an on-going basis. Should circumstances arise necessitating Western's use of additional pipeline capacity to serve firm customers, nothing in this Order precludes the Company from passing the cost of such purchases on to consumers through the PGA on a provisional basis. The prudence (necessity for and price level) of any such purchases, of course, would be subject to subsequent Commission review. Order at page 4.

ORDER

1. Western's Petition for Reconsideration was granted to allow thorough review by the Commission. Having conducted such a review, the Commission

    a. affirms the June 17, 1997 decision approving an 878 Mcf/day increase in additional pipeline capacity entitlements prorated amongst Northern Natural's TF-5, TF-12 B and TF-12 V services according to previously approved allocations; and

    b. clarifies the sound bases of the June 17, 1997 decision as noted in the text of this Order.

2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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